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Israel: Current Economic Situation

General Economic Trends

Israel's economy was in a strong position before the war, even though heavy consumer demand and rising wages fed a high and persistent inflation. The economy was operating near capacity, unemployment was low, and real GNP was growing at an annual rate of about 8%, fast enough to attract and absorb new immigrants. Although Israel's foreign debt was mounting rapidly, the burden was eased by increases in foreign exchange receipts from unilateral transfers and sales of Israeli bonds. Accordingly, Israeli dependence on foreign aid was declining, with a large part of the assistance being used to build up reserve holdings. Foreign exchange reserves totaled $1.5 billion on the eve of the war.

The economy has held up pretty well since the October war despite shifting priorities and economic needs. The rate of real GNP growth in 1974 is forecast to rise slightly to 7% and should approach $9.3 billion ($2,735 on a per capita basis) compared to $8.7 billion in 1973. The rate of inflation, however, also has accelerated and remains a major source of concern. The consumer price index rose 26% in the first nine months of 1974 -- equal to the increase for all of 1973 -- and for the full year the increase will be close to 40%.

The government will spend directly over 70% of Israel's GNP in 1974. Total budget outlays are about 20% above the 1973 level. Defense is claiming more than 40% of the budget, half for foreign arms purchases and the remainder for local procurement including investment in domestic defense industries, salaries, and military construction. On the civilian side, large increases are planned for immigrant absorption, welfare benefits, and trade subsidies. Although budget revenues will fall far short of expenditures, the deficit will be more than offset by US aid for both military and civilian purposes.

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Israel's foreign debt is expected to approach $6 billion this year compared to $5 billion at the end of 1973. Over 90% of the debt outstanding is in long-term maturities, much of it at concessional interest rates. One-third of the debt consists of Israeli bonds. A sizable portion of Israeli bond redemptions are made in local currencies which in turn are invested in Israel and thus represent no foreign exchange burden.

The balance of payments will be in deficit. Earlier this year Israeli officials were forecasting a current account deficit on the order of $3.5 billion which would be offset with $2.8 billion in capital inflows and US aid. We doubt that the fall in reserves will be as large as the $1.1 billion forecast by Israel. Imports of goods and services will be about $300 million lower than forecast while inflows from foreign investment and bond sales will be higher. Accordingly, the drop in foreign exchange reserves should be closer to $400 million than the $1.1 billion forecast by Israel. Foreign exchange reserves currently stand at about $1.2 billion compared to $1.8 billion at the end of 1973.

Government Economic Policies

The government put into effect in July a system of economic measures designed to restrain private demand and thereby curb the inflationary trend as well as stem the worsening balance of payments position. The measures aim at increasing government revenue by over $800 million from new taxes on commodities, wages, business and property, as well as compulsory loans by employers. Official government spending was reduced by nearly $500 million by discontinuing or postponing non-essential public buildings. Private building starts were halted. The government has ordered a 90-day freeze on commercial bank credits. Other measures include an increase of the import surcharge, and a freeze on basic food commodities prices.

The government awarded several hikes in the cost-of-living allowance. A moderate wage increase was accepted by labor during wage negotiations with the government in return for a 20.7% additional cost-of-living increase in July on base pay of $250 per month. An additional increase was scheduled for October.

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